the 1989 budget and social policy

national council of welfare

september 1989

Canada

THE 1989 BUDGET AND SOCIAL POLICY

A Report by the National Council of Welfare

September 1989

Copies of this publication may be obtained from:

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Également disponible en français sous le titre:

<u>Le budget de 1989 et la politique sociale</u>

Cat No. H68-22/1989E
ISBN 0-662-17213-2

TABLE OF CONTENTS

Page

INTRODUCTION 1

CHANGES TO FAMILY ALLOWANCES AND OLD AGE SECURITY

Universality 2

The 'Clawback' 3

Problems With the Clawback on Family Allowances

a. The Clawback Will Hit More and More Canadians at Lower and Lower Income Levels Over Time 9

b. The Clawback Will Discriminate Against One-Earner Families 12

c. The Clawback Will Add to the Complexity of the Child Benefits System 12

d. The Clawback Will Not Redirect Benefits From Rich to Poor 13

e. The Clawback Will Erode the Principle of 'Horizontal Equity' 14

f. The Clawback Will Tax Family Allowances Differently From Other Income 14

g. The Clawback Could Erode Support for Social Programs 14

The Clawback on Old Age Security 15

a. Will You Get an Old Age Pension When You Retire? 16

b. Changing the Rules Without the Players' Consent 19

We Need a Public Debate on the Reform of Child and Elderly Benefits 20

Recommendations 22

OTHER ASPECTS OF THE 1989 BUDGET

Increase in the General Surtax 26

Re-Imposition of a High-Income Surtax 27

Improved Tax Benefits for Some Persons With Disabilities 27

Further Increases in Federal Sales and Excise Taxes 28

Increases in the Refundable Sales Tax Credit 29

Increase in Unemployment Insurance Premiums 30

Further Cuts in Federal Transfers to the Provinces 32

Savings on Planned Child Care Spending 33

INTRODUCTION

Most of the measures in the April 1989 federal budget are a variation on actions taken since the May 1985 budget in order to reduce the deficit. Taxes are up again and federal transfers to the provinces for health and postsecondary education will be squeezed even more. These are familiar measures and were expected.

What came as a surprise was the decision to recover through the income tax system all of the family allowances and Old Age Security benefits paid to higher-income recipients. This 'clawback' on child and elderly benefits is the most significant change in federal social policy in a generation because it marks the end of universality, a fundamental and long-standing principle of Canada's system of social benefits.

The primary purpose of this report is to explain the changes to family allowances and old age pensions. We point out shortcomings of the clawback and recommend alternatives to it. Our paper also briefly reviews other significant features of the 1989 budget. Additional information on trends in social spending, total government spending and revenues, the deficit, inflation, and unemployment is presented at the end of the report.

CHANGES TO FAMILY ALLOWANCES AND OLD AGE SECURITY

Until the 1989 budget, family allowances and Old Age Security were universal social programs. The term 'universality' is often misunderstood, so we must begin by explaining this important concept.

Universality

Family allowances benefit all families with children and Old Age Security payments all elderly persons, regardless of their income. That is why they are called 'universal' programs.

Why deliver benefits to all parents? Because the founders of the family allowances program saw as one of its primary purposes the recognition by the state of the contribution that parents at all income levels make to society in raising future citizens, workers and taxpayers. In addition, family allowances in some small way help compensate parents for the extra cost of raising children that childless couples and single persons do not have to bear.

The same sort of rationale underlies the universal basis of the Old Age Security program. It serves to recognize the contribution that all elderly Canadians - regardless of their financial and other circumstances during their working years - made to society.

Although they deliver the same monthly cheque to all their recipients - $32.74 per child and $330.43 per pensioner - family allowances and old age pensions do not actually provide the same benefits to all their beneficiaries. Payments from both programs are counted as taxable income, so most families and pensioners pay federal and provincial income on their benefits. (Family allowances are taxable in the hands of the higher-income parent in the case of families where both spouses have income).

Because Canada has a progressive income tax system - higher incomes are taxed at higher rates than lower incomes - family allowances and Old Age Security benefits are also progressive in impact: upper-income parents and pensioners pay more income tax on their benefits than do those with average incomes, and middle-income taxpayers more than lower-income taxpayers. Very poor families and seniors who are below the income tax threshold get to keep all of their family allowances and old age pensions. As a result, after-tax benefits from the two programs are largest for lower-income beneficiaries and smallest for higher-income recipients.

Taxfilers in the top tax bracket - those with taxable incomes over $55,000 - pay back about 45 cents for every dollar they receive in family allowances and old age pensions. However, after taxes they end up with more than half (55 percent) of their benefits, no matter how high their income.

The fact that family allowances and old age pensions provide smaller after-tax benefits to higher-income parents and pensioners does not alter their universal nature. **Universality means that all the recipients of a social program end up with some meaningful benefit**.

The 'Clawback'

The budget will require upper-income parents and pensioners to pay back their benefits at a rate of 15 percent of individual net income above $50,000. This is a technical formula that in itself will not mean anything to most people. But what it translates into is a 100 percent taxback on family allowances and old age pensions above a certain income level. Higher-income families and pensioners will have to pay back at income tax time the full amount of the benefits they received over the course of the previous year.

Here is how the new system will work. We look first at family allowances, which in 1989 pay $32.74 a month per child or $393 for the year.

If the higher-income parent's net income is over $50,000, he or she will have to pay back family allowances at a rate of 15 cents of benefits for every dollar of income over $50,000. ('Net income' is total income from all sources less certain items, including contributions to an RRSP or private pension plan, child care expenses and union or professional dues.) The higher the parent's income, the greater the amount of family allowance benefits that will be repaid through the clawback.

For example, a parent with two children and net income of $51,000 will pay back $150 of their family allowances (15 percent of $1,000). The clawback for a parent with two children and net income of $53,000 is $450 (15 percent of $3,000). Parents with net incomes over $55,240 will pay back all of their family allowances.

Table A shows how the clawback on family allowances will operate for families with two children. Parents with net incomes under $50,000 do not pay the clawback; those with net incomes between $50,000 and $55,240 pay what can be termed a 'partial clawback' in that they retain some family allowance benefits because the amount of the clawback is less than the gross family allowance; those with net incomes above $55,240 pay the 'full clawback' since they will forfeit all of their family allowances.

Table A

CLAWBACK ON FAMILY ALLOWANCES

FOR TWO CHILDREN

Parent's Net Income	Gross Benefits	Clawback
$50,000 or less	$ 786	$ 0
51,000	786	150
52,000	786	300
53,000	786	450
54,000	786	600
55,240 or more	786	786

Table B illustrates how the clawback will operate for Old Age Security benefits. The figures differ, but the mechanism is the same as for family allowances: elderly Canadians will repay 15 cents of their old age pension for every dollar of net income above $50,000.

Table B

CLAWBACK ON OLD AGE SECURITY

FOR ONE PENSIONER

Senior's Net Income	Gross Benefits	Clawback
$50,000 or less	$ 3,950	$ 0
51,000	3,950	150
55,000	3,950	750
60,000	3,950	1,500
65,000	3,950	2,250
70,000	3,950	3,000
76,332 or more	3,950	3,950

Because the old age pension is ten times larger than the family allowance ($3,950 as opposed to $393 a year), the 'partial clawback' range - i.e., income levels where pensioners still get to keep some of their old age pension - is much wider. Only

pensioners with net incomes above $76,332 will have to return the full amount of their Old Age Security payments at income tax time.

The clawback on family allowances and old age pensions will be phased in over three years - one-third in 1989, two-thirds in 1990 and the full amount from 1991 on. Tables A and B assume that the clawback has been fully implemented in 1989, in order to illustrate how the mature system will work.

The clawback is actually more complicated than we have indicated. Readers who get a headache from trying to fathom their income tax forms are advised to skip the next paragraphs and go directly to Tables C and D, which show family allowances and old age pensions before and after the clawback introduced in the 1989 budget.

Let's look first at families which do not pay the clawback. In order to calculate the amount of 'net' or 'after-tax' family allowances - i.e., the benefits that families actually end up with after they have paid their income taxes - we have to figure out how much federal and provincial income taxes they owe on their family allowances. We then subtract the tax paid on the family allowances from the gross payments to arrive at net or after-tax benefits.

Things get more complicated for families that will be subject to the clawback. First, we must calculate the amount of family allowances they must repay through the clawback. Next, we have to deduct the amount repaid through the clawback from gross family allowances and then calculate the federal and provincial taxes owing on this amount (i.e., on the difference between gross family allowances and the clawback). Finally, to determine net (i.e., after-tax and clawback) family allowances, we take gross family allowances and subtract from this the sum of the income taxes and clawback payable on the family allowances. The same procedure applies for Old Age Security.

Table C compares after-tax benefits from the family allowances for two children of parents at different income levels. Table D looks at old age pensioners. Remember that, in the case of two-income couples, we are talking about the parent with the higher income, who pays income tax on the family allowances. As with Tables A and B, we show figures for 1989 and assume that the clawback is fully in place.

The 1989 budget will not change the after-tax benefits of parents with net incomes up to $50,000 because they will not have to pay the clawback. However, parents with net incomes above $50,000 will repay more of their family allowances as a result of the clawback. For instance, the after-tax benefits for parents with net income of $52,000 will fall from $469 to $290. Before the budget, parents with net incomes over $55,240 kept $433 or more than half (55 percent) of their family allowances; after the budget, they will end up with nothing.

Table D shows how the 1989 budget will affect pensioners at different income levels. Those with net incomes up to $50,000 will see no change in their after-tax Old Age Security benefits. Those above the $50,000 threshold will have to pay the clawback and so will end up with smaller benefits after tax. Pensioners with net incomes over $76,332 will repay all of their old age pension.

There is no question that the clawback puts an end to universality. While higher-income parents and pensioners will continue to receive monthly family allowance and old age pension cheques during the course of the year, they will pay all the money back to the government the following spring when filing their income taxes for the preceding year. **A social program that delivers benefits to everyone and then collects them all back from some recipients is not universal.**

Table C

AFTER-TAX FAMILY ALLOWANCES FOR TWO CHILDREN, BEFORE AND AFTER 1989 BUDGET

Parent's Net Income	Before Budget	After Budget
$ 10,000	$ 786	$ 786
20,000	579	579
30,000	469	469
40,000	469	469
50,000	469	469
52,000	469	290
54,000	469	111
55,000	433	20
55,240+	433	0

Table D

AFTER-TAX OLD AGE SECURITY FOR ONE PENSIONER, BEFORE AND AFTER 1989 BUDGET

Person's Net Income	Before Budget	After Budget
$ 10,000	$ 3950	$ 3950
20,000	2909	2909
30,000	2358	2358
40,000	2358	2358
50,000	2174	2174
55,000	2174	1762
60,000	2174	1349
65,000	2174	936
70,000	2174	523
75,000	2174	110
76,332+	2174	0

Problems With the Clawback on Family Allowances

The issue of whether upper-income parents and pensioners should or should not receive social benefits is an important one that we will return to later. However, the clawback presented in the 1989 budget has serious flaws that should concern even anti-universalists who believe that family allowances and old age pensions should not serve better-off Canadians.

a. The Clawback Will Hit More and More Canadians at Lower and Lower Income Levels Over Time.

The budget claims that only 14 percent of family allowance families will be subject to the clawback when it is fully phased in. Some 368,000 families will pay back all of their family allowances and another 167,000 will repay part though the clawback. The budget says that only 'higher-income' families will have to pay the clawback.

In fact, the clawback will not hit just affluent families. Some middle-income families will be caught as well. For example, a one-earner couple with two children and net income of $55,240 or more will pay back all of its family allowances as a result of the budget. While such a family is substantially above the $45,000 average income for a one-earner Canadian family with children, it hardly figures in the wealthy category, particularly if it lives in a high-cost city like Toronto or Vancouver.

Another bad feature of the clawback is the fact that the income threshold above which it will be applied will be only partially indexed (to the amount of inflation over 3 percent). This means that more and more parents will become subject to the clawback as the years go by because in most cases their incomes will rise faster than the amount of the clawback income threshold.

Take the case of parents with two children and an income of $40,000 in 1989. This is well below the $50,000 threshold, so they will not be hit by the clawback - not at first, that is.

Assume that their income keeps pace with inflation. By the year 2001, their income will be an estimated $65,524 in current (i.e., 2001) dollars, though that will be worth exactly the same ($40,000) in today's dollars. But the clawback threshold will be indexed only by the amount of inflation over 3 percent a year, so in 2001 it will be about $57,684 in current dollars. Those parents - whose $40,000 incomes hardly put them in the bank president class - will pay back the full amount of their family allowances within just 12 years.

We are not talking about small numbers of families here. According to the budget, there are 530,000 families with incomes in the $40,000-$50,000 range. Today, they are below the income level ($50,000) for the clawback. However, in about eight years all these families will be within the grasp of the clawback. All in all, over one million families or about 29 percent of the 3.8 million total will be subject to the clawback in less than ten years.

The budget assures us that the level of the clawback threshold "will be reviewed periodically and adjusted as appropriate". When is "periodically" and what is "appropriate"? This is not an acceptable way to run a social program. In years to come, governments could announce so-called 'improvements' in the threshold that in fact would only partly restore its original $50,000 level.

Figure 1 illustrates our argument that the clawback will grab more and more middle-income families with each passing year. The graph presents two important pieces of information. The black bars show the net income threshold above which parents are caught by the

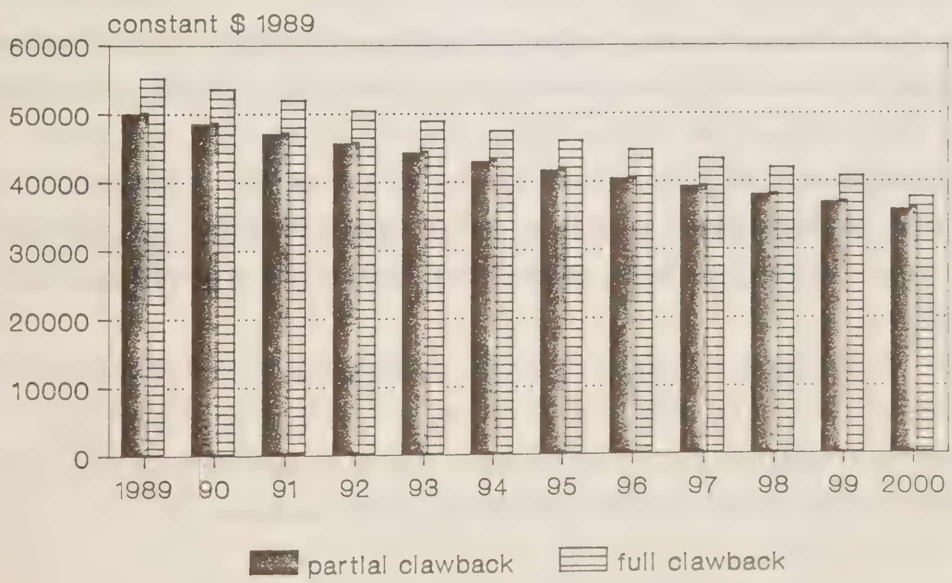
clawback. The striped bars shows the net income level above which parents pay back 100 percent of the family allowance. Those with incomes between these levels pay a partial clawback - i.e., they get to keep a portion of their family allowance benefits.

Figure 1 shows clearly the declining level of the threshold above which the clawback applies. With no adjustments to the threshold, by the turn of the century (which is only 11 years away) the partial clawback will begin at just $35,765 and the 100 percent clawback at $39,512. Even with occasional adjustments, the income threshold for the clawback will creep downward as the years go by.

Because the family allowance rate is also only partially indexed, over time the black and striped bars will move closer together, indicating that the income range for the partial clawback will narrow over time.

Figure 1

INCOME THRESHOLD FOR CLAWBACK ON FAMILY ALLOWANCES, TWO CHILDREN, 1989-2000



b. The Clawback Will Discriminate Against One-Earner Families.

A one-earner family with an income of $56,000 and two children will have to return 100 percent of its family allowance benefits to the federal government once the clawback is fully phased in (1991). However, a two-earner couple with two children in which one spouse earns $45,000 and the other spouse $35,000 - for a joint income of $80,000 - will not have to pay the clawback because the higher-income parent's net income is under $50,000. Instead, this family will be subject only to the normal rate of taxation on its family allowances, returning about 45 percent of its benefits to the federal and provincial governments.

The clawback is both unjust and illogical. The one-earner couple at $56,000 will pay back all of its family allowances. The two-earner couple earning $80,000 ($24,000 more than the one-earner family) gets to keep over half of its family allowances.

c. The Clawback Will Add to the Complexity of the Child Benefits System.

Over the past four years, the Minister of Finance has further complicated an already complex child benefits system. In brief:

- the non-refundable child tax credit, which replaced the children's tax exemption in 1988, is $66 for each of the first two children and $132 for the third and subsequent children.

- families with incomes under $16,000 now receive their refundable child tax credit in two installments, while other families continue to get it only once a year.

- children under age 7 qualify for a $200 supplement to the refundable child tax credit in 1989, so there are now two rates ($565 for children over 7, $765 for those under 7).

- parents with receipted child care expenses can claim a maximum $4,000 tax deduction for each child under 7 but only up to $2,000 for children aged 7 through 14.

- family allowances and both the refundable and non-refundable child tax credits are now indexed only by the amount of inflation over 3 percent a year.

Before the clawback, there were in effect two types of family receiving family allowances: families too poor to owe income tax kept all of their family allowances, while those which pay tax kept part of their family allowances and returned the rest to the federal and provincial governments in the form of income taxes paid on their benefits.

After the clawback, there will be four types of family receiving family allowances - families which keep all of their family allowances because they are too poor to owe income tax; those which keep part of their family allowances because they pay regular income taxes on their benefits; those which keep part of their family allowances because they pay both regular income taxes and the clawback on their benefits; and those which have to pay back all of their family allowances through the clawback.

<u>d. The Clawback Will Not Redirect Benefits From Rich to Poor.</u>

The clawback on family allowances and old age pensions will save the government about half a billion dollars a year when the scheme is fully in effect. This money will be used for deficit reduction, not to improve benefits for low-income families and pensioners.

e. The Clawback Will Erode the Principle of 'Horizontal Equity'.

One of the reasons for paying child benefits to all families - including the better-off - is to recognize their additional financial burden in raising children as compared to childless couples and single persons at the same level of income. This is known as the principle of horizontal equity.

After the clawback, the only benefit available to all higher-income parents will be the $66 per child non-refundable child tax credit. Clearly, removing family allowances from better-off families will put them at a greater disadvantage vis-à-vis childless couples and singles who have the same income but no child-rearing expenses.

f. The Clawback Will Tax Family Allowances Differently From Other Income.

One of the goals of a fairer tax system is to tax income from all sources the same way. The clawback takes Canada a step backward by taxing higher-income taxpayers' family allowances differently than it does their income from other sources such as employment and interest earnings. Taxpayers subject to the full clawback will pay a 100 percent tax rate on their family allowances, which is confiscatory to say the least.

g. The Clawback Could Erode Support for Social Programs.

Over time, more and more families will find themselves in the position of paying back at tax time all of the family allowances they received during the previous year. Inflation will push the clawback's income threshold further and further below $50,000, effectively denying family allowances to increasing numbers of middle-income families.

Some people who study social policy fear that taking benefits away from the middle-income majority eventually will weaken popular support for social programs in general, including those which help the poor. Giving benefits with one hand and then taxing them all back with the other is a hypocritical policy that could engender middle-income voters' resentment at paying taxes for social programs to which they are not really entitled.

The Clawback on Old Age Security

Most of our criticisms of the clawback on family allowances apply to the clawback on Old Age Security benefits, so we will not repeat them all. We will concentrate on two problems - the increasing number of pensioners who will lose their Old Age Security benefits to the clawback as the years go by, and the fact that the clawback changes the rules of the retirement income system without the consent of its participants.

The clawback will affect Canadians 65 and older with net incomes above $50,000. As explained above, pensioners with net incomes between $50,000 and $76,332 will still end up with some Old Age Security benefits after the clawback is applied, while those with net incomes over $76,332 will pay back their entire old age pension once the scheme is fully implemented in 1991.

These seem like high incomes, especially since most elderly Canadians live on low or modest incomes: the average income of families headed by persons 65 and older in 1989 is estimated at around $32,000 and is about $15,000 for a single pensioner. The Minister of Finance claims that the clawback will affect only 128,000 seniors or just 4.3 percent of the aged population.

a. <u>Will You Get an Old Age Pension When Your Reach 65?</u>

Over time, more and more elderly men and women will be hit by the clawback as the partially-indexed $50,000 threshold level drops in value. The less frequently and/or adequately the threshold is adjusted over the years, the more money the government will recoup from pensioners and the larger the number of Canadians who will wind up with no old age pension when they retire.

Let's look at the example of a typical 35 year-old who currently earns $40,000; the average male Canadian working full-time in 1989 earns about $39,000. We assume that this person's earnings rise by 10 percent in real terms during the rest of his career to $44,000 and that he retires at age 65 in the year 2019 on an income (from public and private pension plans) of $35,000 or 80 percent of his pre-retirement earnings. (All figures are expressed on constant 1989 dollars).

Table E shows what happens to this person's old age pension under four scenarios regarding the level of the threshold for the old age pension clawback. We go to all this trouble in order to be as fair as possible - no one knows how the threshold will fare over the years - and also to illustrate what a big difference adjustments to the threshold will make in the old age pension prospects of middle-income workers.

Option 1 (the worst case) assumes that the threshold for the clawback on Old Age Security benefits is not adjusted periodically; since it is only partially indexed (by the amount of inflation over 3 percent a year), it declines in value by 3 percent a year. The Minister of Finance has said that the government will occasionally restore the threshold, though how often and by how much we cannot know; we would not be surprised to see no adjustments over the next several years at least, and maybe even longer.

Option 2 assumes that the threshold is adjusted from time to time so that, on average, it loses 2 percent of its value each year between 1989 and 2019. Option 3 assumes that the clawback threshold is adjusted enough that it drops by only 1 percent each year on average. Option 4 (the best case) shows what happens if the threshold were fully indexed to the cost of living; this is an unlikely scenario since the government has deliberately designed the clawback so that it will not retain its value over time.

When the 35 year-old worker turns 65 in the year 2019, under the worst case scenario (Option 1) the income threshold for the partial clawback will have fallen to $20,050 and the income level for the full (100 percent) clawback will be $46,384. (All figures in Table E are expressed in constant 1989 dollars). Without the clawback, the employee's after-tax benefits from Old Age Security would be $2,358 or 60 percent of gross payments. With the clawback, the worker will end up with only $1,001 or 25 percent of gross old age pension payments.

Under Option 2, this middle-income worker will still be subject to the clawback and will end up with $1,648 after paying the clawback and income taxes on his old age pension. Only under the two more optimistic scenarios - Option 3 in which the clawback loses only 1 percent of its value each year and Option 4 in which it is fully indexed - does this average worker avoid the clawback and thus have to pay only normal income taxes on his Old Age Security payments, ending up with after-tax benefits of $2,358 or 60 percent of gross payments.

Table E also looks at workers with somewhat higher incomes. One earns $45,000 at age 35 and retires with a pension income of $39,600. The other earns $50,000 at age 35 and retires on $44,000. Although they have a comfortable income, neither of these pensioners could be considered affluent.

Table E

OLD AGE SECURITY BENEFITS FOR EMPLOYEE AGED 35 IN 1989, BY EARNINGS AND SCENARIO

$40,000	Option One	Option Two	Option Three	Option Four
a. clawback threshold				
partial	$20,050	$27,274	$36,985	$50,000
full	46,384	53,608	63,318	76,332
b. amount of clawback	2,273	1,189	0	0
c. old age pension after clawback and taxes	1,001	1,648	2,358	2,358
d. as % of gross OAS	25 %	42 %	60 %	60 %
$45,000				
a. clawback threshold				
partial	$20,050	$27,274	$36,985	$50,000
full	46,384	53,608	63,318	76,332
b. amount of clawback	2,933	1,849	392	0
c. old age pension after clawback and taxes	607	1,254	2,124	2,358
d. as % of gross OAS	15 %	32 %	54 %	60 %
$50,000				
a. clawback threshold				
partial	$20,050	$27,274	$36,985	$50,000
full	46,384	53,608	63,318	76,332
b. amount of clawback	3,593	2,509	1,052	0
c. old age pension after clawback and taxes	213	860	1,730	2,358
d. as % of gross OAS	5 %	22 %	44 %	60 %

Note: Gross (pre-tax) benefits from OAS are $3,950.
All figures are expressed in constant 1989 dollars.

After paying the clawback and income taxes on his old age pension, the $45,000 worker will end up with $607 or just 15 percent of his $3,950 old age pension under Option 1, $1,254 or 32 percent under Option 2 and $2,124 or 54 percent under Option 3. This person would avoid the clawback only if the $50,000 threshold were fully indexed over the years, in which case he or she would get the same after-tax benefits - $2,358 or 60 percent of the old age pension - as under the old system.

The clawback will take back a big chunk of the $50,000 earner's Old Age Security payments under Options 1, 2 and 3. After paying the clawback and income taxes on his old age pension, he will end up with just $213 or 5 percent of his $3,950 gross payments under Option 1, $860 or 22 percent under Option 2 and $1,730 or 44 percent under Option 3. Only in the unlikely case that the threshold for the clawback ends up at the same $50,000 level in 2019 (in 1989 dollars) as in 1989 will this elderly Canadian be spared the clawback.

b. Changing the Rules Without the Players' Consent.

The clawback on old age pensions also changes the rules of the game for elderly Canadians as well as for those under 65 who have been counting on receiving Old Age Security payments as part of their retirement income. The government's own Consultation Paper on Child and Elderly Benefits, released in January of 1985, recognized this problem as grounds for rejecting the idea of a 'surtax' (another word for the clawback) on old age pensions:

> A special surtax on Old Age Security payments to return more of the benefit paid to upper income pensioners would seriously disrupt our retirement income system, both for current pensioners and those now planning for retirement, and would unduly penalize those most affected by reason of retirement income resulting from private savings in earlier years.

It can be argued that the elderly have paid for their old age pensions through a lifetime of paying income taxes and, from 1952 to 1971, a special tax on income ear-marked to help finance Old Age Security payments. They count on the old age pension as part of their retirement income. The clawback changes the rules of the game without the consent of the players.

Initially, only relatively well-off pensioners will be hit by the clawback, so repaying more or all of their Old Age Security benefits at income tax time will not hit them as hard as it would elderly women and men living on average or modest incomes. However, to the extent that this and future governments allow inflation to lower the income threshold for the clawback, increasing numbers of middle-income Canadians no longer will be able to count on Old Age Security as part of their income after age 65. They had better start putting aside more of what savings they can manage into RRSPs or other savings plans in order to make up for their lost income from the old age pension.

We Need a Public Debate on the Reform of Child and Elderly Benefits

The reason for paying family allowances and old age pensions to all parents and pensioners - regardless of their income - is to recognize their special contribution to Canadian society. The clawback introduced by the 1989 budget maintains the appearance, but not the reality, of universality. Its purpose is to cut social spending, not to improve benefits for low-income families and pensioners.

Universal social programs have had their critics since before they were put in place at the end of World War Two. (Family allowances were first paid in 1945). Some Canadians have never agreed with paying social benefits to the affluent. They want either to use the money that is spent on higher-income parents and pensioners to

improve benefits for lower-income families and seniors, or to apply the resulting savings to deficit reduction.

Others support universality in principle but believe the nation can no longer afford to pay family allowances and old age pensions to the better-off. Like the anti-universalists, they divide between those who would redirect benefits to low-income parents and pensioners and those who feel the money should be used to help fight the deficit.

Still others vigorously defend universality. 'Universalists' believe that the child-rearing efforts of all parents and the contribution to society of all elderly women and men deserve public recognition in the form of income security benefits. They argue that universal programs treat all their recipients alike and help foster a sense of community, unlike for-the-poor-only benefits such as welfare which set their recipients apart and tend to stigmatize them as second-class citizens. Universal programs are also cheaper and easier to administer than social programs which impose income or needs tests as a condition for initial and ongoing eligibility.

Universalists fear that the 1989 budget will pave the way for further cuts in benefits to middle-income Canadians and, over time, will weaken public support for social programs that help lower-income families and individuals. They contend that restricting child and elderly benefits to an ever-shrinking clientele will weaken the stimulus to the economy that flows from the goods and services which are purchased by family allowances and old age pension cheques.

These different points of view deserve to be debated openly and thoroughly. Unfortunately, the clawback announced in the 1989 budget puts an end to universality without the prior public debate such a momentous change should receive. A budget is not the place

to alter the very foundation of Canada's social programs.

Rather than eliminating universality through the back door, we believe the federal government should launch a public debate on the issue. If after that debate it still wants to deny benefits to higher-income Canadians - and that is not a position we support - then at least the government should do so in a straightforward manner, by converting child and elderly benefits into income-tested programs which provide benefits only to those below a specified income level, along the lines of the refundable child tax credit and the Guaranteed Income Supplement.

Recommendations

The National Council of Welfare's preference is a universal but more progressive income security system for Canadians under 18 and over 65 based on family allowances and Old Age Security benefits received by all recipients, regardless of income. Rather than imposing a clawback which denies benefits to higher-income families and pensioners, we believe that family allowances and old age pensions should remain taxable under the regular income tax system, so that higher-income recipients would continue to receive a substantial portion of their benefits after tax.

Social programs can be more progressive in their distribution of benefits while remaining universal. The National Council of Welfare's pre-budget report, Social Spending and the Next Budget (April 1989), recommended that the top marginal income tax rate be raised from its current 29 percent to at least 32 percent as one among several reforms to collect more income taxes from all upper-income taxpayers. Such a change means that higher-income parents and pensioners would pay somewhat more income tax on their family allowances and Old Age Security benefits than they did under the old system, although they would still end up with a substantial

portion of their benefits - unlike after the clawback, when they will repay all of their benefits.

If the top tax rate were increased to 32 percent, parents and pensioners in the top tax bracket (those with taxable incomes over $55,000) would receive average after-tax benefits of 50.4 percent of gross family allowances and Old Age Security payments, compared to 55.0 percent under the old system. Upper-income families and seniors would end up with half of their family allowances and old age pensions after tax under our proposal.

Our proposals for a fairer income tax system would collect far more revenue than the clawback on social programs. The reforms we put forward in <u>Social Spending and the Next Budget</u> - raising the top income tax rate from 29 percent to 32 percent, eliminating the $100,000 lifetime capital gains exemption, fully taxing capital gains and converting the RRSP deduction to a tax credit - would raise about $2 billion more a year, which is four times the $500 million the government will get from the clawback on family allowances and Old Age Security payments.

Our approach is fairer as well as more lucrative. The clawback means that upper-income taxpayers who have children or are elderly must bear more of the burden of fighting the deficit than those without children and under age 65. Our reforms will collect more income tax from all better-off Canadians.

The Minister of Finance partially de-indexed the family allowances program in 1986. Instead of adjusting the benefit rate by the full increase in the cost of living, the government now increases the rate only by the amount of inflation over 3 percent, which automatically cuts its value by 3 percent each year. In 1989, the annual family allowances for one child will amount to $393, whereas the payment would have been $440 if it had remained fully protected

against inflation. In order to prevent further deterioration in the value of the family allowance, we recommend that it be fully indexed to the cost of living.

Family allowances are only one part of the federal child benefit system. Over the years, the National Council of Welfare has studied child benefits at length and recommended reforms to the system. We wish to reiterate these proposals.

Since the 'seventies, we had recommended that the government abolish the children's tax exemption and use the savings that result to increase the refundable child tax credit. The government followed our advice in part when it eliminated the children's tax exemption in its 1988 tax reform, but instead of redirecting the resulting savings to boost the refundable child tax credit, it created a non-refundable child tax credit which now pays $66 for each of the first two children and $132 per child for the third and subsequent children. This change was an improvement, but it also needlessly increased the complexity of the child benefits system and created an inequity as between smaller and larger families.

We recommend that the non-refundable child tax credit be eliminated and the resulting savings used to increase the refundable child tax credit. Both the refundable child tax credit and the income threshold above which benefits are reduced by 5 percent of additional income (the threshold is $24,355 in 1989) should be fully indexed to the cost of living.

In 1988, the finance minister doubled the maximum child care expense deduction for children under age seven (from $2,000 to $4,000). This change went against his own tax reform, which converted most deductions and exemptions to non-refundable credits, and diverted more scarce resources to higher-income parents. We repeat the recommendation we made in our 1988 report <u>Child Care:</u>

A Better Alternative: the child care expense deduction should be converted to a non-refundable child care credit of $340 per child.

In summary, we recommend:

1. **The federal government should abandon its plan to apply a clawback to family allowances and Old Age Security payments.**

2. **Family allowances and Old Age Security should remain universal programs providing meaningful after-tax benefits to all families with children and all elderly Canadians.**

3. **The non-refundable child tax credit should be abolished and the resulting savings used to increase the refundable child tax credit.**

4. **The child care expense deduction should be converted to a non-refundable child care credit of up to $340 per child.**

5. **All child benefits - family allowances, the refundable child tax credit (and its threshold for maximum benefits) and the married equivalent credit for single-parent families - should be fully indexed to the cost of living.**

OTHER ASPECTS OF THE 1989 BUDGET

The clawback on family allowances and Old Age Security payments is by far the most significant social policy change in the 1989 budget. However, there were additional measures affecting taxes and other social programs that we will review briefly.

Although the finance minister was under pressure from some business organizations to slash government spending, in fact the 1989 budget dealt a heavier dose of tax increases than spending cuts. The measures announced in the budget will save some $5.2 billion in 1989-90, of which $1.5 billion or 29 percent will come from spending reductions and $3.7 billion or 71 percent from tax changes. In 1990-91, the budget provisions will yield an estimated $9 billion - $2.1 billion or 23 percent from expenditure restraint and $6.9 billion or 77 percent from tax hikes.

Increase in the General Surtax

Since 1986, taxpayers at all income levels have had to pay a surtax (i.e., an extra amount of income tax) calculated as 3 percent of basic federal tax. The 1989 budget raised this general surtax by 2 percentage points to 5 percent of basic federal tax as of July of 1989. Because the change occurs half-way though the year, the effective rate for the general surtax will be 4 percent for 1989 (six months at 3 percent and six months at 5 percent). In 1990, taxpayers will pay the full 5 percent of their basic federal tax. All 13.5 million taxpayers will pay the higher general surtax.

In dollars terms, the surtax takes more from upper-income taxpayers since they pay more income tax, but in percentage terms it affects all taxpayers the same. For instance, a single person under age 65 earning $10,000 in 1990 ($2,663 below the estimated poverty line for a single person living in a city of 500,000 or larger) will pay

$30 through the general surtax (5 percent of basic federal tax of $590); a single person earning $40,000 will pay $349 in general surtax (5 percent of basic federal tax of $6,973); and someone earning $80,000 will pay $937 in general surtax (5 percent of basic federal tax of $18,750).

By raising the general surtax to 5 percent of basic federal tax, the federal government will collect about $1 billion more a year in income taxes.

Re-imposition of a High-income Surtax

From July 1985 to December 1986, the federal government levied a surtax that collected more income tax from upper-income taxpayers; the rate was 5 percent of basic federal tax between $6,000 and $15,000 and 10 percent of basic federal tax above $15,000.

The 1989 budget re-imposes a high-income surtax. It is 3 percent of basic federal tax over $15,000 effective July of 1989, which translates into incomes over $70,000. For instance, a taxpayer with income of $80,000 will pay $112 through the high-income surtax, in addition to the $937 he or she owes in general surtax, for a combined surtax of $1,049 or 5.6 percent of basic federal tax, as compared to 5 percent for lower and middle-income taxpayers.

The high-income surtax will collect about $200 million a year from an estimated 335,000 taxpayers or 2.5 percent of all taxpayers.

Improved Tax Benefits for Some Persons With Disabilities

Workers certified as having "a severe and prolonged impairment" will be allowed to deduct from their taxable income the costs of care provided by a part-time attendant who is an unrelated adult.

The maximum tax deduction will be two-thirds of eligible income (defined as income from a job, a training allowance under the National Training Act or a grant for research or similar work) up to $5,000.

The purpose of this tax deduction is to recognize the extra expenses a worker with a severe disability faces in paying for an attendant so that he or she can work in the paid labour force. For example, a single person eligible for the maximum tax deduction ($5,000) who earns $20,000 will save on average $1,318 in combined federal and provincial income taxes in recognition of the costs of attendant care.

This new tax break will cost about $5 million a year.

Further Increases in Federal Sales and Excise Taxes

Every budget since 1985 has jacked up federal sales and excise taxes in order to raise more revenue. The 1989 budget is no exception to this pattern.

The federal manufacturers' sales tax rate on construction material and equipment for buildings will rise from 8 percent to 9 percent on January 1, 1990; the rate on alcoholic beverages, from 18 percent to 19 percent on April 28, 1989; the rate on telecommunications and programming services, from 10 percent to 11 percent on June 1, 1989; and the rate on all other taxable goods, from 12 percent to 13 percent on June 1, 1989.

The federal government will collect an additional $800 million in 1989-90 and $1.7 billion in 1990-91 as a result of its changes to the manufacturers' sales tax.

Excise taxes are also going up. There will be a 1-cent-a-litre increase in the excise tax on gasoline and aviation gasoline on April 28, 1989 and another 1-cent-a-litre hike on January 1, 1990. The excise tax on leaded gasoline and aviation gasoline will rise by the same amount on April 28, 1989. The excise tax on cigarettes will go up by $4 per carton, with a proportional increase in the excise tax on cigars, on April 28, 1989. The excise tax on manufactured tobacco will see a $4-per-200-grams jump on April 28, 1989 and another $1.30-per-200-grams rise on October 1, 1989.

These excise tax increases will collect another $1.3 billion in 1989-90 and $1.6 billion in 1990-91.

Increases in the Refundable Sales Tax Credit

In 1986, the federal government brought in a refundable sales tax credit to protect low-income Canadians from the effects of increases in the federal sales tax, though the sales tax credit does not and was not intended to offset the full impact of the sales tax on the poor. The sales tax credit is paid once a year through the income tax system.

The refundable sales tax credit will be increased over the next few years in order to shield low-income consumers from the impact of the sales tax increases announced in the 1989 budget. The credit for adults will increase from its current $70 for 1988 to $100 in 1989 and $140 in 1990. The sales tax credit for children will rise from its current $35 per child to $50 in 1989 and $70 in 1990. The income threshold above which the refundable sales tax credit is reduced (by five percent of net family income) will move from its current $16,000 in net family income to $18,000 in 1990.

These improvements to the refundable sales tax credit will cost Ottawa $135 million in 1989-90 and $465 million in 1990-91.

In August of 1989, the Minister of Finance released details of the proposed Goods and Services Tax that will replace the old manufacturers' sales tax in 1991. The refundable sales tax credit will be boosted and broadened in order to offset part of the burden of the new sales tax on low-income Canadians.

In 1991, the maximum sales tax credit will be $275 per adult and $100 per child. Eligible single parents will receive the adult rate ($275) for one of their children. Single adults, including single parents, will be eligible for an additional credit of up to $140 if their net income is between $6,175 and $24,800. The level above which the new sales tax credit is reduced will be raised to the threshold for the refundable child tax credit - $24,800. The new sales tax credit will cost $3.6 billion in 1991.

The Goods and Services Tax and its tax credit will be examined in a separate National Council of Welfare study.

Increase in Unemployment Insurance Premiums

The government is planning an overhaul of the unemployment insurance program. One element of its reform package was contained in the 1989 budget and involves how the UI program is financed.

Until the 1989 budget, unemployment insurance was funded by employers, employees and the federal government. The government paid for the cost of regionally extended benefits, benefits for self-employed fishermen that are in excess of the premiums they pay, and extended benefits paid to persons in approved training and job creation projects. In 1989, Ottawa will pay an estimated $2.9 billion or 23 percent of the $12.6 billion price tag for the unemployment insurance program.

As of 1990, the federal government will no longer pay for part of unemployment insurance, although it will consider reassuming some of the costs "in difficult economic times when it is inappropriate to raise premiums". These changes will save the federal government $425 million in 1989-90 and $1.9 billion in 1990-91.

The entire cost of unemployment insurance will be financed by employers and employees. As a result, UI premiums for employees will rise from their current (1989) $1.95 per $100 of insurable earnings (the maximum payment is $613 a year and applies to workers earning $31,460 or more) to $2.25 per $100 of insurable earnings for 1990 though 1992 (the maximum payment will be $743 and will apply to employees earning $33,020 or more in 1990).

An employee earning $15,730 (half the $31,460 maximum insurable earnings in 1989) pays a total of $307 in UI premiums. However, the government allows a non-refundable credit to lighten the burden of premiums (the credit is 17 percent of the annual premium). This employees's non-refundable credit reduces federal and provincial income taxes payable by, on average, $81, so the net UI premium (i.e., after deducting the tax credit) is $226. Next year, when the higher rate comes into effect, that worker's net UI premium will amount to $261 or $35 more than in 1989 (we have converted the 1990 figures to constant 1989 dollars). This amounts to a 15.4 percent real increase in after-tax-credit UI premiums.

An employee earning three-quarters of the maximum insurable earnings ($23,595 in 1989) will see his or her net UI premiums increase by $53 or 15.5 percent, from $339 to $392. Those earning the maximum insurable earnings or above ($31,460 or more) will experience a $71 (15.8 percent) increase in their net UI premiums, which will go from $451 in 1989 to $523 in 1990. (Again, 1990 figures are expressed in constant 1989 dollars).

The UI premium rate for employers will remain 1.4 times that for employees. It will rise from $2.73 per $100 of insurable earnings in 1989 to $3.15 per $100 of insurable earnings for 1990 through 1992.

While the new UI premiums are higher than those in effect in 1989, they are still lower than the rates for 1988. In 1988, employees paid $2.35 per $100 in insurable earnings and employers paid $3.29 per $100 of insurable earnings.

Further Cuts in Federal Transfer Payments to the Provinces

Under the Established Programs Financing Act (EPF), the federal government provides $24 billion in cash payments to the provinces to share the cost of insured health services, extended health care and postsecondary education. In 1986, the Minister of Finance restricted the annual increase in federal transfers under EPF to the increase in the Gross National Product less two percentage points; before that, federal grants went up by the full increase in the Gross National Product.

The 1989 budget further restrained federal payments to the provinces for health and postsecondary education by changing the indexing formula to the rise in the GNP less three percentage points, effective in 1990-91. This change will save the federal government an additional $200 million in 1990-91 and more thereafter.

Most Canadians will feel the effects of these cuts in federal transfers one way or another. The provincial governments could react by reducing their funding for health care and postsecondary institutions (which, in turn, could cut back their services and/or raise their fees), cutting back on spending in other areas and/or raising their income and sales taxes.

Savings on Planned Child Care Spending

In 1988, the federal government announced a three-part child care strategy made up of a change in federal/provincial financing arrangements in order to increase the number of child care spaces, increased tax assistance to families with young children and children with special needs, and a fund to support research and development into child care initiatives.

The government went ahead with the tax measures: it doubled the child care expense deduction for children under seven years old and increased the refundable child tax credit by $200 for each child under age seven, at a cost of about $2.3 billion from 1988 to 1995. The existing child care expense deduction will cost some $1.4 billion over the period, so the total cost of these tax measures will amount to about $3.7 billion over seven years. The child care initiatives fund also went ahead, at a cost of $100 million over seven years.

However, in the interest of deficit reduction, the 1989 budget announced that the government would not go ahead with its plan to spend more money in order to create more child care spaces. According to the budget, this sum amounts to a very large $4 billion over the seven-year period.

This is a misleadingly high figure. It includes some $2.6 billion which the federal government would have spent over seven years on cost-sharing provincial and territorial child care programs under the old system (through the Canada Assistance Plan). Therefore, a more accurate price tag for the planned - and now apparently delayed - new federal spending is more like $1.4 billion, not $4 billion.

The new money announced in the child care strategy would have come with a very big string attached: instead of the open-ended approach of the Canada Assistance Plan in which the federal government matches what the provinces spend, the new cost-sharing mechanism would have imposed ceilings on federal transfers for child care over the next seven years, and federal funds would have increased only by the increase in the cost of living after 1995.

The federal government's child care plans are unclear at the moment. The 1989 budget says only that "the government will act to meet its child care objectives" before the end of its term in office. However, Ottawa is likely to shift its funding for child care from an open-ended to a limited system so as to restrain future spending.

TABLE F

FEDERAL EXPENDITURES AND REVENUES, CONSTANT (1989) DOLLARS, 1984/85-1990/91

($ millions)

Expenditures	1984-85	1985-86	1986-87	1987-88	1988-89	1989-90	1990-91
Statutory Social Programs							
unemployment insurance	12,386	11,869	11,888	11,436	11,449	11,930	12,156
old age pensions	14,070	14,839	15,304	15,647	16,013	16,395	16,857
family allowances	2,980	2,963	2,884	2,796	2,725	2,610	2,527
Canada Assistance Plan	4,615	4,640	4,611	4,630	4,816	4,780	4,777
Established Programs Financing	10,591	10,280	10,061	9,596	9,332	9,140	9,228
Total Social Spending	44,642	44,591	44,748	44,105	44,335	44,855	45,545
Total Non-social Spending	62,276	57,057	57,388	61,133	60,464	58,645	58,566
Total Program Spending	106,917	101,648	102,135	105,238	104,800	103,500	104,111
Public Debt Charges	27,670	30,142	30,343	31,654	34,584	39,400	38,041
Total Budgetary Expenditures	134,587	131,790	132,478	136,892	139,384	142,900	142,152
Revenues							
Personal Income Tax	36,048	39,107	43,114	49,207	47,998	50,445	52,638
Corporate Income Tax	11,557	10,912	11,251	11,862	12,576	13,700	13,986
Sales and Excise Taxes	17,377	20,038	23,918	25,016	27,290	28,760	29,166
Unemployment Insurance Premiums	9,307	10,322	10,879	11,368	11,774	10,655	11,827
Other	13,065	10,639	8,479	8,814	9,458	8,830	7,776
Total Revenues	87,354	91,017	97,641	106,268	109,097	112,400	115,403
Deficit	47,233	40,773	34,837	30,624	30,287	30,500	26,749

Figure 2
FEDERAL DEFICIT
1984/85-1990/91

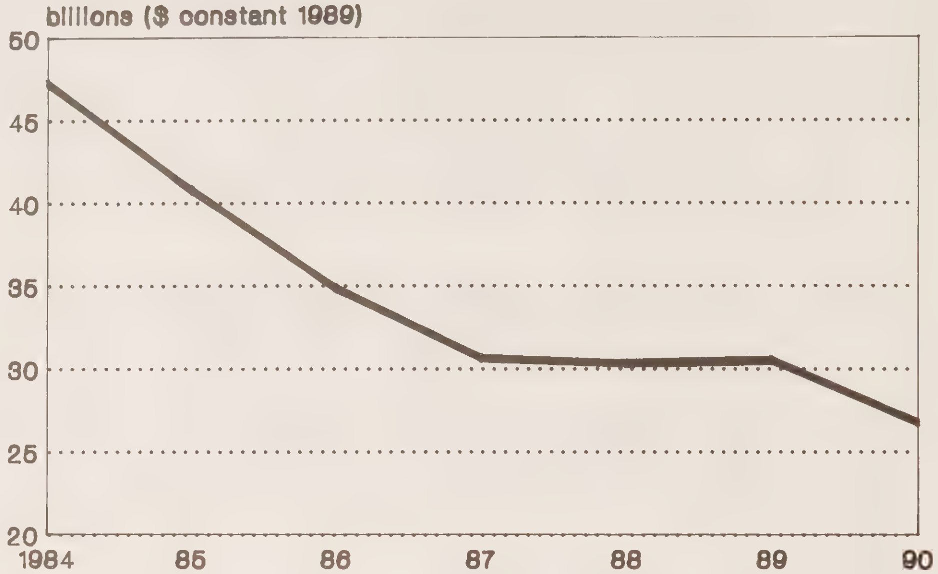


Figure 3
FEDERAL DEFICIT AS PERCENTAGE OF
GROSS DOMESTIC PRODUCT, 1984/85-1990/91

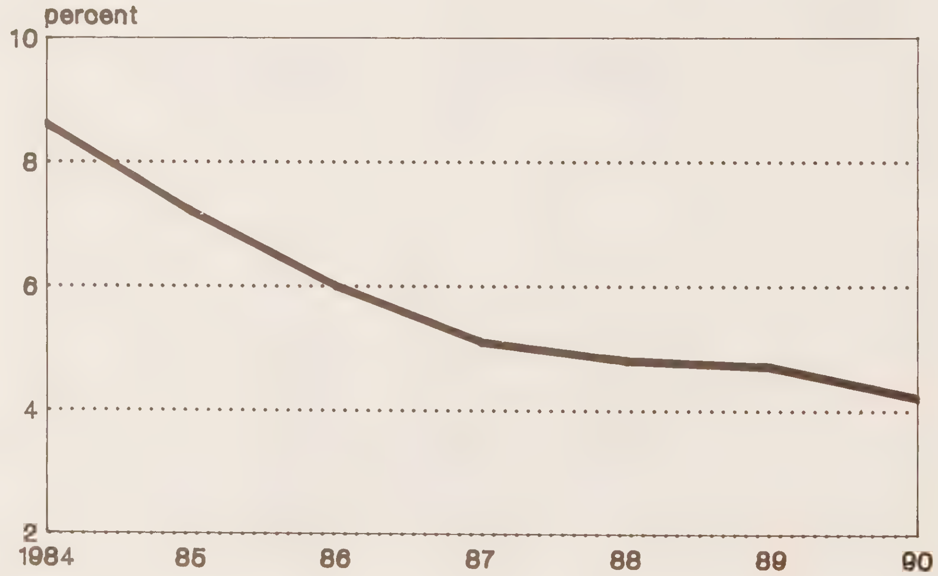


Figure 4
FEDERAL EXPENDITURES, BY MAJOR CATEGORY, 1984/85-1990/91

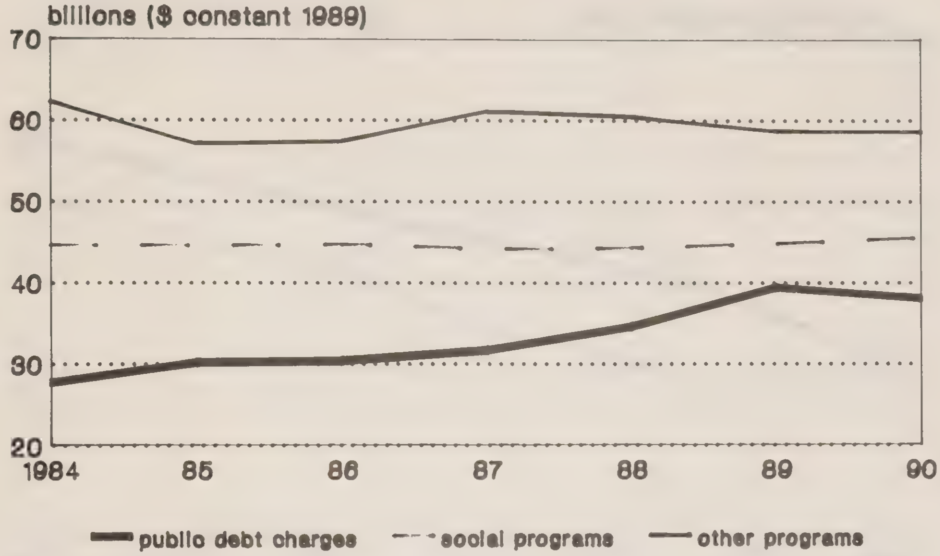


Figure 5
FEDERAL SOCIAL SPENDING, BY PROGRAM, 1984/85-1990/91

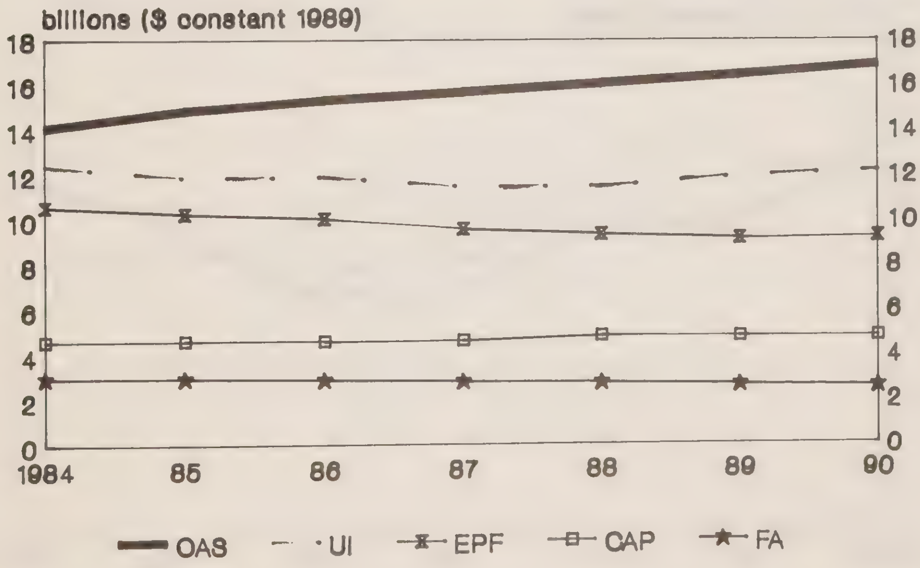


Figure 6

OLD AGE PENSIONS SPENDING
1984/85-1990/91

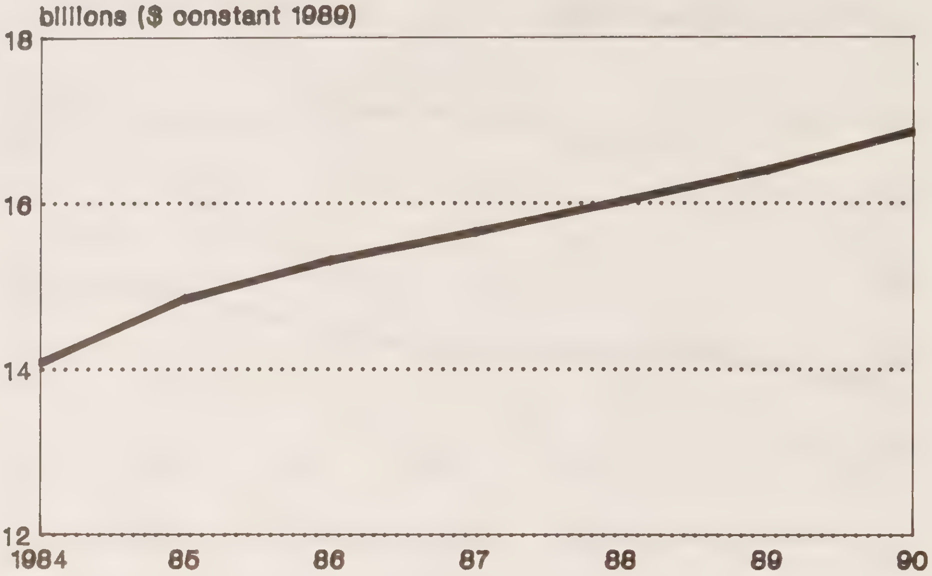


Figure 7

UNEMPLOYMENT INSURANCE SPENDING
1984/85-1990/91

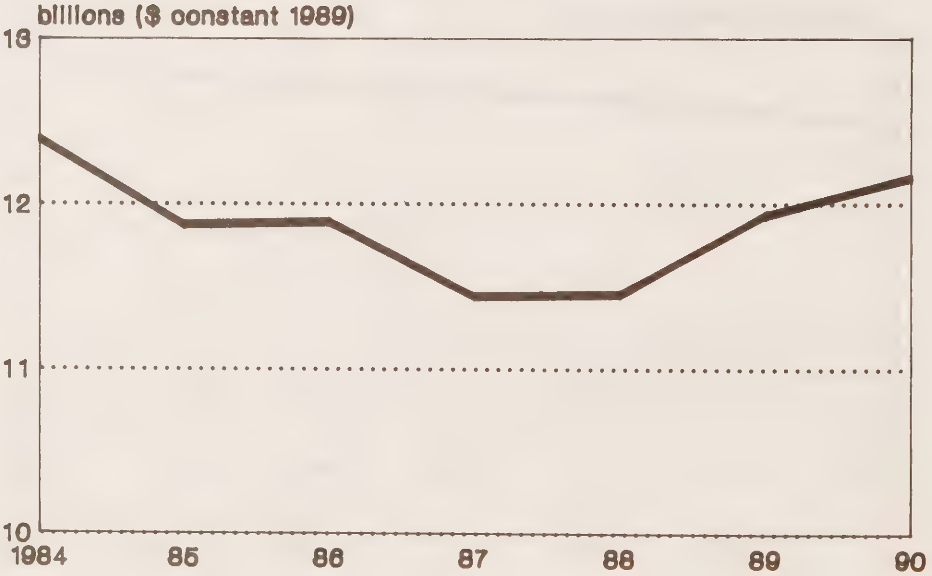


Figure 8
ESTABLISHED PROGRAMS FINANCING
SPENDING, 1984/85-1990/91

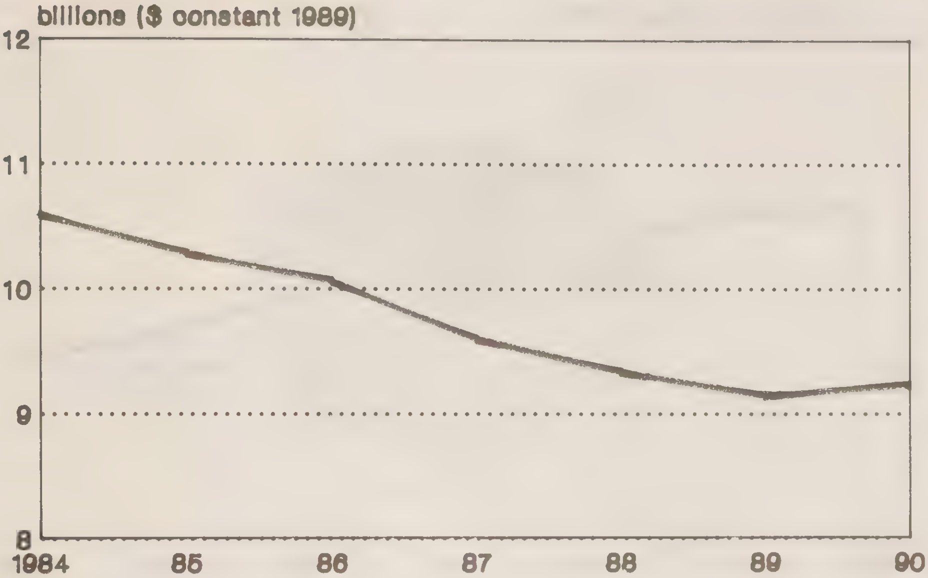


Figure 9
CANADA ASSISTANCE PLAN
SPENDING, 1984/85-1990/91

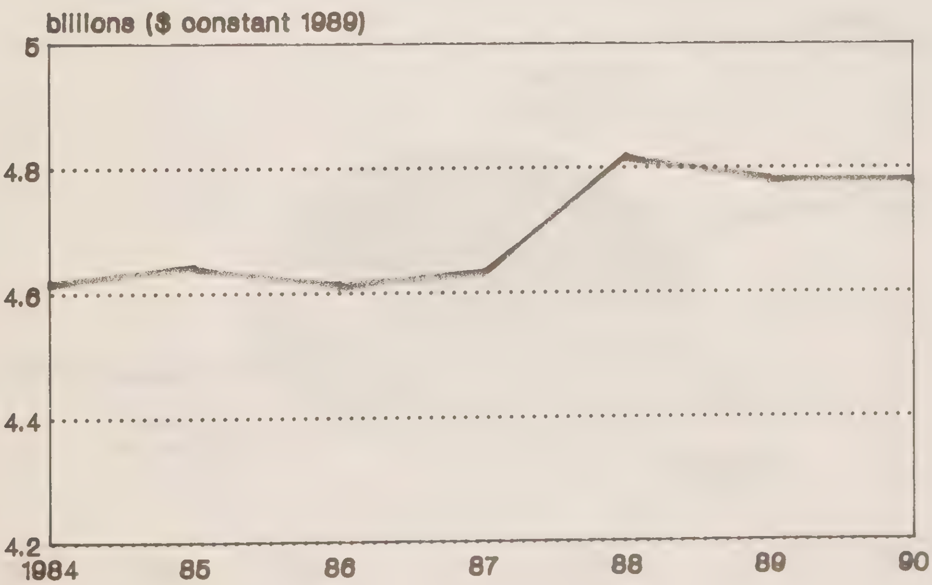


Figure 10

FAMILY ALLOWANCE SPENDING
1984/85-1990/91

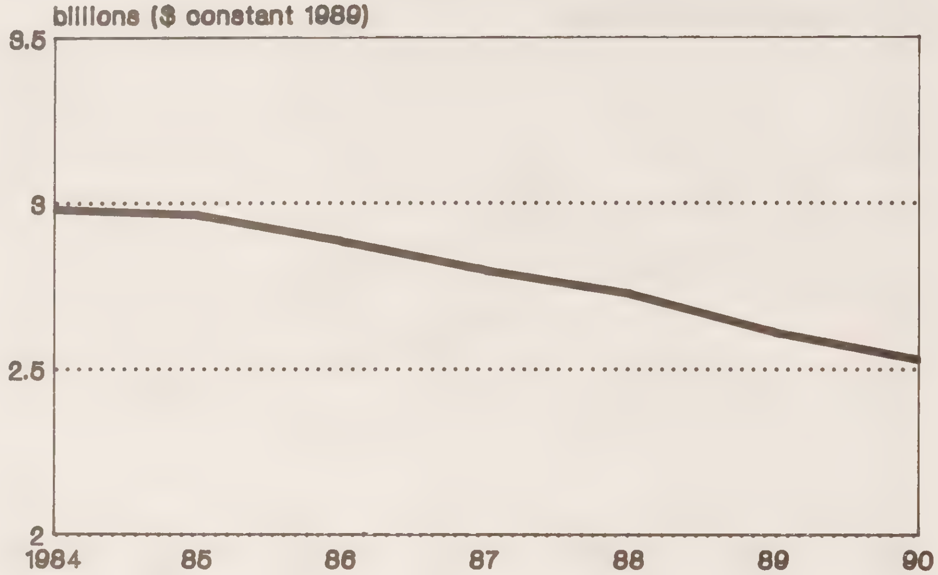


Figure 11

SOCIAL SPENDING AS PERCENTAGE OF
GROSS DOMESTIC PRODUCT, 1984/85-1990/91

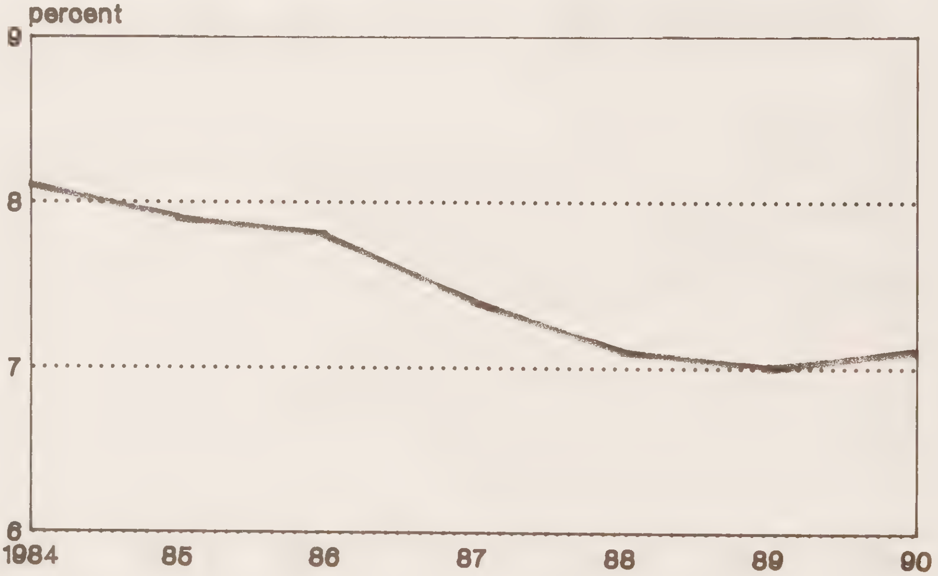


Figure 12

FEDERAL REVENUES,
BY SOURCE, 1984/85

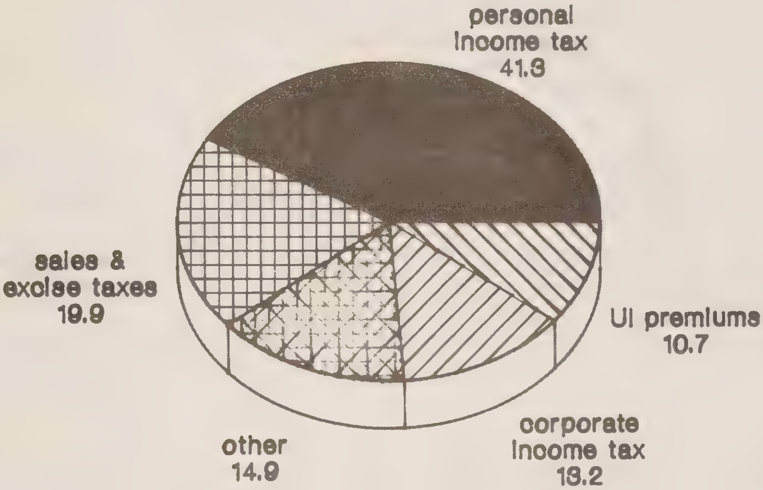


Figure 13

FEDERAL REVENUES,
BY SOURCE, 1990/91

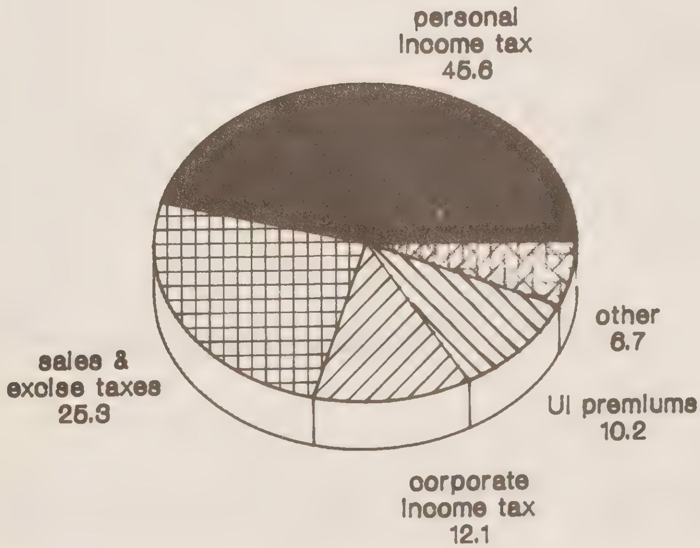
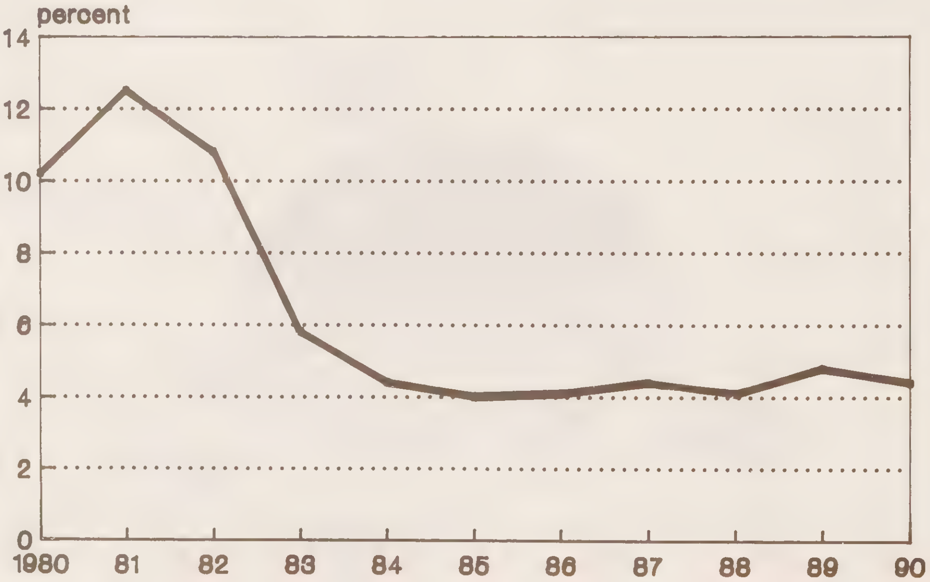


Figure 14
UNEMPLOYMENT RATE,
1980–1990

Figure 15
INFLATION RATE,
1980–1990



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Translation: Louise Ducharme

NATIONAL COUNCIL OF WELFARE

The National Council of Welfare was established by the Government Organization Act, 1969 as a citizens' advisory body to the Minister of National Health and Welfare. Its mandate is to advise the Minister on matters pertaining to welfare.

The Council consists of 21 members, drawn from across Canada and appointed by the Governor-in-Council. All are private citizens and serve in their personal capacities rather than as representatives of organizations or agencies. The membership of the Council has included past and present welfare recipients, public housing tenants and other low-income citizens, as well as lawyers, professors, social workers and others involved in voluntary service associations, private welfare agencies, and social work education.

Reports by the National Council of Welfare deal with a wide range of issues on poverty and social policy in Canada, including: income security programs, medicare, poverty lines and poverty statistics, the retirement income system, the aged, tax reform, the working poor, children in poverty, community economic development, women and poverty, employment policy, single-parent families, social services, nutrition, community organizing, child welfare, poor people's groups, legal aid/legal services, low-income consumers, poverty coverage in the press and welfare reform.

On peut se procurer des exemplaires en
français de toutes les publications du
Conseil national du bien-être social,
en s'adressant au Conseil national du
bien-être social, Immeuble Brooke Claxton
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